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SUBJECT: COTTON CONTRACT PROBLEM

REF: (A) MANILA 9522 (B) MANILA 11820 (C) STATE 184746

-- (D) MANILA 11079

1. WASHINGTON AGENCIES APPRECIATE MISSION'S LATEST REPORT ON COTTON CONTRACT SITUATION AND ARE GRATIFIED THAT PROGRESS IN REDUCING SIZE OF PROBLEM IS EVIDENT. PARAGRAPHS BELOW REVIEW OUTSTANDING ISSUES AND RECOMMEND APPROPRIATE ACTION. SUGGESTED TEXTS FOR REPLIES TO OCAMPO LETTER TO AMBASSADOR ON YUPANGCO - CIEC AND SOLID - STARKE TAYLOR CONTRACTS FOLLOW BY SEPTEL.

2. AMERICAN COTTON EXPORTERS' ASSOCIATION OFFICIALS REPORT
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THAT HOHENBERG AND STAPLE COOPERATIVE HAVE REACHED AGREEMENT

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WITH LIRAG ON CONTRACT CANCELLATION. ACEA OFFICIALS ARE OPTIMISTIC THAT U.S. SHIPPERS WOULD RESPOND FAVORABLY TO PROPOSALS FROM CENTRAL, UNITED ASIA AND LIRAG FOR TERMINATION OF CONTRACTS OUTSTANDING WITH THOSE FIRMS. ACCORDING TO THESE OFFICIALS, SHIPPERS ARE CONCERNED ABOUT POSSIBLE LEGAL EFFECT OF FORMALLY GIVING CANCELLATION NOTICE. WHILE SHIPPERS CITE ARBITRATION AND OTHER PROVISIONS OF CONTRACT, THEY ARE ALL AWARE OF CIEC EXPERIENCE AND PREFER TO HAVE PHILIPPINE MILLS TAKE CLEAR STEP TOWARD NEGOTIATED TERMINATION.

3. CIEC - YUPANGCO CASE PRESENTS PROBLEM OF DIFFERENT ORDER. FIRST, OBJECTIVES OF DBP AND YUPANGCO ARE NOT CLEAR. AT EARLIER STAGE, YUPANGCO WAS SEEKING AVOID PERFORMANCE OF CONTRACTS AND DBP SHOWED RELUCTANCE TO PRESS FOR PERFORMANCE. IT NOW APPEARS YUPANGCO IS SEEKING PERFORMANCE OF SOME OR ALL CONTRACTS AND DBP AGAIN SUPPORTING YUPANGCO - PARTICULARLY REGARDING CONTRACTS FOR WHICH LETTERS OF CREDIT WERE ISSUED - ALBEIT WITHOUT CARRYING CHARGES. MORE IMPORTANTLY, IN VIEW COURT JUDGMENT OBTAINED BY YUPANGCO AGAINST CIEC LATTER CAN HARDLY BEEXPECT EDCOOPERATE IN EFFORT TERMINATE YUPANGCO'S OBLIGATIONS UNDER CONTRACTS AND DBP'S UNDER ASSURANCES WHILE JUDGMENT REMAINS IN EFFECT.

4. WASHINGTON AGENCIES REQUEST EMBASSY INFORM DBP OF ACEA'S VIEWS REGARDING SHIPPERS'RECEPTIVITY TO TERMINATION PROPOSALS AND SUGGEST THAT DBP INVITE MILLS TO FORWARD TERMINATION PROPOSALS TO SHIPPERS. PROPOSALS SHOULD ANTICIPATE MUTUAL INTEREST OF PARTIES IN ELIMINATION OF ANY POTENTIAL LEGAL LIABILITY RESPECTING CONTRACTS OR THEIR TERMINATION. OF COURSE, PROPOSALS FROM YUPANGCO FOR TERMINATION SHOULD INCLUDE MEASURES FOR REMOVAL OF ANY LEGAL LIABILITY ON CIEC'S PART IN RESPECT TO COURT JUDGMENT AS WELL.

5. WASHINGTON AGENCIES HAVE NOTED REPORTS FROM EMBASSY THAT CERTAIN U.S. COTTON SHIPPERS MAY NOT BE ALLOWED TO DO BUSINESS IN THE FUTURE IN THE PHILIPPINES. WE SEE NO JUSTIFICATION FOR MEASURES BY PHILIPPINE GOVERNMENT
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AGENCIES TO PREVENT U.S. SHIPPERS FROM DOING BUSINESS IN PHILIPPINES. WHILE IT IS OBVIOUSLY UNFAIR TO PENALIZE U.S. SHIPPERS WHEN ENTIRE EPISODE GREW OUT OF FAILURE OF PHILIPPINE MILLS TO MAKE TIMELY PERFORMANCE OF COTTON CONTRACTS, THERE IS A MORE FUNDAMENTAL PRINCIPLE INVOLVED. THE USEFULNESS OF GOVERNMENTS IN BRINGING PRIVATE PARTICIPANTS IN AN INTERNATIONAL COMMERCIAL TRANSACTION TO A MUTUALLY ACCEPTABLE RESOLUTION OF THEIR DIFFERENCES SHOULD

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NOT OBSCURE THE INAPPROPRIATENESS OF GOVERNMENTS' IMPOSING
PENALTIES ON FOREIGN FIRMS WHEN THEIR EFFORTS ON BEHALF
OF DOMESTIC PARTICIPANTS IN LEGALLY DISPUTED MATTERS FAIL.
WHILE A FORMAL PROTEST DOES NOT APPEAR WARRANTED AT THIS
TIME, EMBASSY SHOULD SATISFY ITSELF THAT DBP AND OTHER
GOP AGENCIES ARE AWARE OF FIRM U.S. POSITION RESPECTING
ACTIONS OF KIND REPORTEDLY THREATENED.

6. U.S. POSITION ON STARKE - TAYLOR - SOLID MILLS DISPUTE
IS UNCHANGED. PROPOSED REPLY TO OCAMPO COVERS MAJOR POINTS.
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